

**POLICE & FIRE PENSION INVESTMENT BOARD  
OCTOBER 27, 2005**

Members present: Don Taute, Don Herz, Greg Sorensen, Mark Meyerson, Randall Case, Brad Thavenet, Mark Westphalen, Gerry Finnegan, Michael Donnelly.

Member absent: None

Personnel Dept.  
Resource Staff: Paul Lutomski, John Cripe

Consultants: Max Callan, Todd Peterson

9:00 a.m. In July the Board approved a new asset allocation mix and the sale of the pension's shares of the Smith Hayes Cap 25 fund (in the MidCap Growth asset class).

Max Callan detailed the process he used to create a short list of possible MidCap Growth funds using Zephyr StyleAdvisor software. Todd Peterson detailed the process he used to create a short list of possible MidCap Growth funds using Morningstar software. Together they detailed how Alger MidCap Growth was finally chosen. They recommend Alger MidCap Growth to replace the Smith Hayes Cap 25 as the MidCap Growth fund.

Max Callan and Todd Peterson also recommend American Funds World Growth and Income as the Global strategy.

Discussion and questions follow with a decision to vote on the recommendation at 2 p.m.

10:00 a.m. Mr. Jason Brown of Hotchkis Wiley MidCap Value presents: He explained that HW was founded in 1980 as research based selling to institutions only with a value philosophy using a buy and hold strategy. In 1995 HW was purchased by Merrill Lynch with the intent to market HW funds to institutions and individuals. In 1996 ML purchased Mercury Asset Management, which dwarfed HW, and HW funds were not marketed as expected. HW employees were originally going to finalize the buy back of HW operations and client accounts from ML on September 11, 2001 but postponed the buy back until October 11, 2001 because of the terrorism attack on the World Trade Center. HW is now 60% owned by its managers and 40% by The Steven's Group.

HW grew from \$4 billion to now \$28 billion of assets under management. They sub-advise for Vanguard Windsor II fund.

They have always stayed true to one philosophy: Value. They model the Ben Graham value method and do lots of research. Value investing has

less downside risk. Three-four year holding period for idea/purchase to fruition/turnaround. Buy low and sell high.

Example: Risk of bankruptcy – Delphi filed for bankruptcy October 17, 2005 because new bankruptcy regulations to take effect. HW started buying Delphi in 1999. Process prohibited holding a large stake in Delphi so bankruptcy and lowered stock price did not hurt fund much. They have not sold and may not.

Example: Sears – good stock, bad company. In 2003 high value after purchase by K-Mart.

Target is 60 to 80 stocks in portfolio of the 800ish considered mid-cap. MidCap is \$0.5 billion to \$15 billion capitalization. Turnover is 25-33%. Normally fully invested. 5% max exposure in any one stock. 15% max exposure in any one industry,

Now it is hard to find good value stocks. They do not sector bet, and so have missed out on the recent energy stock run-up. Big bets in insurance, but not Allstate – they had no re-insurance in Louisiana (referring to recent damage inflicted by hurricanes Rita and Katrina). Big bet in pharmaceuticals, but not Merck (Merck won New Jersey lawsuit 11/3/05 regarding Vioxx). Also like EDS and Computer Associates. Not buying good managers or stories, they buy free cash flow and fundamentals. Have an unwavering discipline to process.

11:00 a.m.

Steve Caruthers of American Funds presents: He explained the multiple manager / analyst system of fund management employed by American funds and their worldwide research network.

He commented on the global economy. 2004 pace was highest in 25 years due to rapid growth in Brazil, Russia, India and China. At that time unaffected by increased oil prices. In 2005 pace had lessened and oil prices have increased. Interest rates have remained low and stable or slowly rising. Japan's stock market performed well. American Funds invests in China's growth by purchasing shares of companies that sell to Chinese government and Chinese companies, but does not purchase shares of Chinese companies directly. Capital World Growth and Income Fund seeks to provide long-term growth of capital with current income by investing in established, growing companies all over the world, including the United States and that makes it very flexible. The turnover is 300-400% annually. The style varies to take advantage of market conditions between growth and value and all market capitalizations, locations and industries. The fund has participated in the run-up seen in energy stocks.

12:00 p.m.

Lunch

1:00 p.m.

Bob Atkinson of Zephyr StyleAdvisor software presents: He explained Standard Deviation. **Standard deviation** is a statistic that tells you how

tightly all the various examples are clustered around the mean in a set of data. When the examples are pretty tightly bunched together and the bell-shaped curve is steep, the standard deviation is small. When the examples are spread apart and the bell curve is relatively flat, that tells you you have a relatively large standard deviation. S.D. is the square root of variance and variance is the sum of the squared differences between each data point and the average value of all data points, divided by one less than the number of data points. Simply put, a bigger SD means larger swings in the historical value of a stock or fund price.

BETA is a measure of how closely a fund moves compared to an index. If a stock has a beta of one it move exactly with the index. If a fund has a beta has of .9 for every 1% the index goes up the fund goes up .9% and conversely in a down situation.

Sharpe ratio is a measure of reward to risk. It is a ratio developed by Bill Sharpe to measure risk-adjusted performance. It is calculated by subtracting the risk free rate from the rate of return for a portfolio and dividing the result by the standard deviation of the portfolio returns. The Sharpe ratio tells whether the returns of a portfolio are because of smart investment decisions or a result of excess risk. Higher ratio is better.

R-squared is a statistical measure that represents the percentage of a fund's or security's movements that are explained by movements in a benchmark index. It should be 80+%.

Up / Down Capture measures how closely a fund or stock captures the index's up or down movements. Ideally, you would want to capture all of the upside movement and none of the downside movement.

Information ratio is a measure displaying how well a manager uses the information available to him or her. It is excess return divided by tracking error (compared to the applicable index). A higher information ratio is better.

Significance level is a measure displaying a fund's chances of beating the returns from random stock selection. The level ranges from 50 to 100, with 100 best. A 99 level means the fund has a 1% chance that random stock selection will beat the fund's return performance,

Gerry Finnegan asked if Zephyr could be used to create a custom index for a fund. Mr. Atkinson said it could and that it has an Allocation Advisor function that may be useful.

2:00 p.m.

Mark Meyerson asked for discussion and vote on accepting Smith Hayes recommendation to purchase Alger MidCap Growth to replace the Smith Hayes Cap 25 as the MidCap Growth fund, and to purchase American Funds World Growth and Income as the Global strategy.

Don Taute made a motion to adopt the recommendations.

Don Herz seconded the motion.

All members voted unanimously to approve.

Brad Thavenet asked for an update on the ordinance to mandate the City contribute normal cost to the pension. Discussion included 13.5% return, funding status expected to improve from 95 to 96%, and UAAL expected to improve from \$7.2 to 6 million. Administration will recommend ordinance to Mayor as soon as possible after finalizing implementation date and slight change to existing language to include that date and City contribution of administration expenses. Draft language will be given to Police and Fire committee members.

Greg Sorensen asked for an ordinance to use overfunding for benefit enhancements in the future. Brad Thavenet asked what benefits a 2% additional employee contribution would buy the employees. Discussion held and agreed that Police and Fire unions should get together and decide what benefits they would like to pursue and how much they would be willing to increase their contribution to pay for it.

Meeting adjourned at 3:05 p.m.